Internal Revenue Service

memorandum

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Br1:JCAlbro

date: MAY 22 1991

to: District Counsel, [redacted]
Attn: [redacted]

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: Inside Wiring, Reinstallation and Reconnection Costs

This is in response to your request for litigation assistance dated April 10, 1991.

ISSUE

Whether the [redacted] settlement undermines the general requirement to seek advance approval of a change in method of accounting with regard to other telephone companies?

CONCLUSION

Settlements are fact specific and unique, and, therefore, the [redacted] settlement is neither binding nor precedential. Nevertheless, the Service has a duty of consistency and uniformity of treatment to taxpayers which tends to support settling this issue with taxpayers, especially in light of our position that expensing the costs at issue is the correct treatment. However, if an unauthorized change in accounting method issue is raised for an appropriate reason and not settled, we would consider litigating that issue.

FACTS

The docketed years in [redacted] were [redacted]-[redacted], and the settlement with respect to the inside wiring issue covered [redacted]-[redacted]. We had concluded in a tax litigation advice, dated January 22, 1988, that inside wiring reconnection and reinstallation costs were currently deductible business expenses rather than intangible costs subject to amortization. [redacted] had historically treated all costs relating to inside wiring, whether a new installation, reinstallation or reconnection, as capital expenditures for book and tax purposes and claimed accelerated depreciation and investment tax credit. In 1981, the Federal Communications Commission (FCC) authorized the expensing of inside wiring costs and ruled that if authorized by the state regulatory commission, a telephone company could charge the current customer full freight for

installing or reconnecting an inside wiring station and expense the related costs in the same year. [redacted] did receive regulatory permission in [redacted] to increase charges and expense all inside wiring station connection costs. On [redacted], [redacted] filed a Form 3115 on behalf of [redacted] seeking permission to deduct inside wiring costs in the year incurred in a manner conforming to the FCC prescribed treatment. In apparent anticipation of a denial of the application, it was withdrawn. Although the FCC in 1981 authorized the expensing of all inside wiring costs, including initial installation costs, our 1988 litigation advice stated that initial installation costs should continue to be capitalized pursuant to Rev. Rul. 84-24, 1984-1 C.B. 89 until the ownership of the wiring was transferred (either through state property law or regulatory action) from the company to the customer. Pursuant to FCC orders, the relinquishment of ownership of inside wiring would occur when such costs had been fully amortized, and in any event no later than January 1, 1987. We advised that when the company no longer owns the wiring, initial installation costs should be currently deducted.

In [redacted], [redacted] began deducting for tax purposes all inside wiring expenses. Because Service position was that expensing of reinstallation and reconnection costs was the correct tax treatment, a settlement of that case allowed the expensing of such costs from [redacted] through [redacted], and initial installation costs were capitalized. The settlement used a cut-off method rather than a section 481 adjustment to avoid any duplication or omission of income or deductions. [redacted] was recaptured on pre-1981 capitalized costs which were reallocated as deductible expenses. For reinstallations and reconnections performed prior to 1978, the depreciation accounts were not adjusted.

We understand that [redacted]'s [redacted] and [redacted] years are under Appeals jurisdiction and that they have reconsidered their previous request for expense treatment of reinstallation and reconnection costs. Now they want to maintain capitalization for those years. Accordingly, we advised that as capitalized costs, the disallowance of depreciation and ITC should be conceded, because inside wiring is a tangible rather than an intangible asset.

Your advice request indicates that like the [redacted] settlement, [redacted] is in the process of settling with Appeals and a cut-off method rather than a section 481 adjustment is contemplated in conjunction with the change in method of accounting from capitalizing to expensing certain inside wiring costs. Pursuant to the cut-off method, pre-1981 capitalized costs will continue to be amortized.

You state that taxpayers under audit by Examination or under Appeals jurisdiction have taken various positions on the

reinstallation and reconnection issue. Some taxpayers have followed the [redacted] settlement; some have continued capitalizing and amortizing all inside wiring costs; other taxpayers may have changed to full expensing of these costs, but evidently not in total conformity with the methodology of the [redacted] settlement; and some taxpayers are submitting claims for a section 481 adjustment, computing expensing, net of depreciation claimed, of all previously capitalized inside wiring costs.

DISCUSSION

As you stated, Service position is that expensing of reinstallation and reconnection costs is the correct tax accounting treatment. We believe that expense treatment may properly be implemented by the Appeals Division in the first open year in conjunction with either a cut-off or section 481 adjustment. That is, a settlement which allows expense treatment must involve the negotiation of terms and conditions to prevent a distortion of income. In addition, of course, any settlement involves both parties' evaluations of their best interests as well as various tradeoffs. With this issue, we believe that the most feasible resolution in an individual case may depend on such factors as the quality of taxpayer's records and the complexity of calculating a section 481 adjustment verus a cut-off adjustment.

The Appeals Division has the authority to resolve this issue on a case by case basis, depending upon the taxpayer's individual circumstances and the other issues involved in the case. The facts do vary among taxpayers, and we do not view the [redacted] settlement as a pattern settlement which must be followed without deviation. At the same time, of course, the Service seeks to treat taxpayers consistently. Appeals must individually evaluate each case, and whether a particular taxpayer did or did not make an unapproved change in accounting method from capitalizing to expensing reinstallation and reconnection costs should not be determinative of a Service settlement position.

We believe that the Examination Division has the discretion not to raise an unauthorized change in accounting method issue. We also believe that if Exam chooses to set up the issue, the Appeals Division would most likely settle with the taxpayer. If an unauthorized change in accounting method issue is raised and not settled, we would consider litigating the issue. Our legal position for litigation purposes is clear. An unauthorized change in method of accounting is impermissible even if the taxpayer is changing from an incorrect to a correct method which more clearly reflects income. Diebold, Inc. v. United States, 16 Cl. Ct. 193, aff'd, 891 F.2d 1579 (Fed. Cir. 1989). See also Southern Pacific Transp. Co. v. Commissioner,

75 T.C. 497, 682 (1980) (Consent required when a taxpayer retroactively attempts to alter the manner in which item accounted for on tax return). Whether we would litigate a particular case must be based, of course, on the facts of that case. An example of a favorable litigation vehicle would be a case in which we challenged a change from capitalization to expensing because taxpayer's records were insufficiently documented and precluded calculating a proper section 481 adjustment. Yet, we recognize that if we litigated an unauthorized change of accounting method, we would face some degree of equity related litigation hazards, notwithstanding adequate support for our legal position in case law.

If a taxpayer makes an accounting method change without first securing the Commissioner's consent, the Commissioner has the authority, at his discretion, to accept or reject such change. Thus, the Service may accept the taxpayer's change of methods and bind the taxpayer to that change. See, e.g., Fowler Bros. v. Commissioner, 138 F.2d 774, 776 (6th Cir. 1943). Our equity related hazards, of course, relate to the [redacted] settlement. In the circumstances at issue, not only do we believe that expensing the costs is the correct accounting treatment, but we have negotiated at least one settlement on that basis. We believe other taxpayers may argue abuse of discretion and inconsistent treatment with respect to the [redacted] settlement. See, e.g., Ogiony v. Commissioner, 617 F.2d 14, 18 (2d Cir. 1980) (Consistency over time and uniformity of treatment among taxpayers are proper benchmarks from which to judge IRS actions.); Sirbo Holdings, Inc. v. Commissioner, 476 F.2d 981, 987 (2d Cir. 1973) (The Commissioner has a duty of consistency toward similarly situated taxpayers; he cannot properly concede capital gains treatment in one case and without adequate explanation, dispute it in another having seemingly identical facts which is pending at the same time.) We would counter, of course, that one settlement does not create a binding precedent, and the facts among taxpayers will vary on this issue. For example, we understand that the Service may settle with [redacted] by conceding the disallowance of depreciation and [redacted] for capitalized reinstallation and reconnection costs. However, our litigation posture must seem consistent and reasonable to a court. We would have to justify our refusal to allow taxpayers to change from an incorrect to a correct accounting method.

Thus, on one hand, there are some litigation hazards in not settling this issue with all taxpayers on the same basis; on the other hand, notwithstanding a policy imperative for equity and consistency, because every settlement is unique, the Commissioner is not bound by a settlement with a particular taxpayer. This proposition flows logically from the fact that taxpayers may not use or cite written determinations or rulings as precedent, I.R.C. § 6110(j)(3). Thus, taxpayers may not

rely upon unpublished private rulings not issued specifically to them, Hanover Bank v. Commissioner, 369 U.S. 672, 686 (1962), nor is the Service bound by rulings with respect to other taxpayers. Penn Truck Corporation v. United States, 77-1 USTC (CCH) ¶ 16,255 (D.C.N.D. Ill. 1977). Even published rulings have none of the force or effect of Treasury Decisions and do not commit the Department to any interpretation of the law. Helvering v. New York Trust Co., 292 U.S. 455, 468 (1934).

In summary, both private rulings and settlements are fact specific and unique and are neither precedential nor binding. Overriding this principle, though, is the Commissioner's duty of consistency and uniformity of treatment among taxpayers. Given that a major goal of the Service is the utilization of proper accounting methods and the uniform treatment of taxpayers, we would prefer settling this issue.

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